

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
NEW JOLLY SWAGMAN INN CORP. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period June 1, 1983 :
through May 31, 1986. :

In the Matter of the Petition :
of :
WINFRIED PIECHUTZKI, :
OFFICER OF NEW JOLLY :
SWAGMAN INN CORP. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period June 1, 1983 :
through May 31, 1986. :

DETERMINATION

In the Matter of the Petition :
of :
LAURA PIECHUTZKI, :
OFFICER OF NEW JOLLY :
SWAGMAN INN CORP. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period June 1, 1983 :
through May 31, 1986. :

Petitioners, New Jolly Swagman Inn Corp., Winfried Piechutski, officer of New Jolly Swagman Inn Corp. and Laura Piechutski, officer of New Jolly Swagman Inn Corp., 100 West Nicholai Street, Hicksville, New York 11801, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1983 through May 31, 1986 (File Nos. 805151, 805152 and 805154).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on December 11, 1989 with all briefs to be filed by April 9, 1990. Petitioners appeared by Susan DiLernia, C.P.A., with Herbert Mintz, Esq., on the brief. The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

ISSUE

Whether the Division of Taxation's use of a U.S. Corporation Income Tax Return as a basis for determining petitioners' taxable sales was proper and, if so, whether the additional taxable sales determined as a result thereof were correct.

FINDINGS OF FACT

Petitioner New Jolly Swagman Inn Corp. was a restaurant which served Australian and German cuisine. The restaurant had a U-shaped bar in the center and tables and chairs on both sides of the bar which, in total, could accommodate approximately 150 patrons. On the second floor there was a banquet room which could accommodate approximately 50 people. The restaurant was located in a residential neighborhood.

In or about July 1986, the Division of Taxation ("Division") commenced a field audit of the restaurant. The restaurant was selected for an audit, because the Division found a discrepancy between the gross sales reported on the restaurant's U.S. Corporation Income Tax Return and the restaurant's sales and use tax returns for the same period of time. Upon scheduling a field audit appointment, the Division sent a letter requesting that the restaurant have available all books and records pertaining to its sales tax liability for the period under audit including journals, ledgers, sales and purchase invoices, cash register tapes, exemption certificates and sales tax records. In addition to this letter, the Division mailed a checklist of needed records which specifically requested the restaurant's general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns, sales tax returns and worksheets, fixed asset invoices, guest checks and cash register tapes for the period March 1984 through May 1984, resale, exempt and capital improvement certificates for March 1984 through

May 1984, New York State corporation tax returns, the latest New York State WRS-2 return and the latest withholding tax returns and checks to New York City and New York State.

In response to the foregoing request, the auditor was presented with the restaurant's records except that there were no check or cash disbursement records for the period August 1984 through May 1986. The auditor was also not furnished with any information on one of the restaurant's bank accounts. In addition, the auditor was not provided with the restaurant's Federal and New York State return for the fiscal year ending July 31, 1985 or the Federal return for the fiscal year ending July 31, 1986. Lastly, some of the restaurant's serially-numbered guest checks were missing.

The auditor found that gross sales reported on the restaurant's Federal income tax return for the fiscal year ending July 31, 1984 were \$219,995.00 whereas the gross sales shown on petitioner's sales and use tax returns for the same period of time were \$156,504.00. The auditor ascertained that the reason for this difference was that the sales tax returns were prepared by the principals of the restaurant from the restaurant's sales journal whereas the restaurant's Federal income tax returns were prepared by its accountant.

The auditor opined that the markup determined by the amounts shown on the Federal returns was adequate for this type of business and therefore the Division accepted the gross sales shown on the Federal return.

In order to calculate the amount of sales tax due the Division computed a margin of error of .405 by dividing the difference between gross sales shown on the restaurant's Federal income tax returns for the fiscal year ended July 31, 1984 and the sales tax returns for the same period of time ($\$219,995.00 - \$156,504.00 = \$63,491.00$) by the gross sales shown on the sales tax returns. Additional taxable sales were then determined by multiplying the error rate by the gross sales shown on the sales tax returns. Lastly, the Division calculated additional tax due by multiplying the additional taxable sales by the applicable tax rate (either 8% or 8.25% depending on the period).

On the basis of the foregoing audit, the Division issued a Notice of Determination and

Demand for Payment of Sales and Use Taxes Due, dated December 30, 1986, to the restaurant. The notice assessed sales and use taxes for the period June 1, 1983 through May 31, 1986 in the amount of \$18,715.78 plus penalty of \$4,183.88 and interest of \$4,458.58 for a total amount due of \$27,358.24. The Division also issued notices dated December 30, 1986 which assessed the same amount of tax, penalty and interest against Laura Piechutski and Winfried Piechutski as had been assessed against the restaurant. The latter notices explained that, as officers, Laura Piechutski and Winfried Piechutski were liable for the taxes due from the restaurant.

After the foregoing assessments were issued, a conference was held wherein petitioners presented an amended U.S. Corporation Income Tax Return which was filed for the fiscal year ending July 31, 1984. Petitioners also presented U.S. corporation income tax returns for the fiscal years ended July 31, 1985 and July 31, 1986. On the amended Federal return for the period ended July 31, 1984, the gross sales corresponded with the sales which had been reported on the sales and use tax returns.

Upon receipt of the new information, the auditor agreed to perform additional audit work. Thereafter, the auditor examined the restaurant's bank records and found that for the fiscal year ended July 31, 1985 there was a total of \$117,133.19 deposited. Of the total amount deposited, \$1,600.00 was in cash. During the same period of time, the total deposits to the restaurant's account at Long Island Trust were \$45,869.64 of which \$4,200.00 was made in cash. During the fiscal year ending July 31, 1986, the total deposits into the restaurant's account at the State Bank of Long Island were \$119,687.97 of which \$4,440.00 was cash. During the same period of time, the total deposits into the restaurant's Long Island Trust account were \$31,602.41 of which \$700.00 was cash. The Division also found that for the fiscal year ended July 31, 1985, the U.S. Corporation Income Tax Return reported gross sales of \$164,414.00 while total bank deposits during the same period of time were \$163,002.83. For the fiscal year ended July 31, 1986, the U.S. Corporation Income Tax Return reported gross sales of \$144,624.00 while total bank deposits during the same period were \$150,990.38. The auditor also ascertained that for the fiscal year ended July 31, 1984 recorded purchases of food by check

were \$13,772.78 whereas the recorded check purchases of liquor were \$29,972.94.

Upon completing this review, the auditor concluded that the amended returns would not be given any weight because, in the auditor's opinion, the returns presented at the conference did not take into account cash payouts. That is, the auditor concluded that the cash which was received from sales was being used to pay for purchases without being recorded in bank accounts or journals. The auditor also concluded that the restaurant's records were inadequate because the respective purchases of food and liquor were not consistent with restaurant activity and because food purchases were only 31 percent of the total recorded check purchases.

During the period in issue, the restaurant served a small local clientele. A high percent of the restaurant's sales were paid by credit card. The rest of the people who patronized the restaurant were local professionals who maintained an account with the restaurant. These people would make periodic payments by check.

The restaurant had one cash register which was located behind the bar. Following a sale, the waitress would give the check to the bartender who would run the check through the cash register machine which would stamp the amount of the sale and the sales tax. The guest checks would then be placed into a small rack next to the cash register. At the end of a shift, all of the guest checks were totalled. Also, the cash register tapes were totalled and balanced against the guest checks. Both the guest checks and cash register tapes were available to the auditor.

Petitioners have not seen the accountant who prepared the U.S. Corporation Income Tax Return for the fiscal year ended July 31, 1984 since sometime in 1984. Petitioner's current accountants were retained in or about the end of March 1987. Upon being retained, the current accountant discovered that returns had not been prepared for the fiscal years ending July 31, 1985 and July 31, 1986. Therefore, they proceeded to prepare and file the necessary returns.

When one of the current accountants started examining the check disbursement journals, he found that generally, with the exception of the wage expense, the amounts stated on the U.S. Corporation Income Tax Return for the fiscal year ended July 31, 1984 did not correspond with

the amounts recorded in the check disbursements journal. Thus, the amounts on the tax returns for items such as rent, utilities, advertising and taxes were all erroneous. The accountant did note that one amount that was accurately reported was payroll. However, this account was separately maintained by a computer payroll firm.¹

Usually, the restaurant paid for its purchases by check.

During the period in issue, Winfried Piechutski took mortgages on his home to provide funds for the restaurant.

Although requested, petitioner's representative was not provided with a complete set of workpapers prior to the hearing. However, she was given an opportunity to examine the workpapers before they were received in evidence. Subsequently, they were received in evidence without objection.

SUMMARY OF PETITIONERS' POSITION

It is petitioners' position that the restaurant's records were adequate to reflect its tax liability and therefore the Division did not have the authority to disregard the restaurant's records. As corollaries to this argument, petitioners argue that the auditor prejudged this case and only performed a cursory audit. It is also argued that the Division's failure to provide petitioners with a complete set of workpapers prior to the hearing deprived them of due process. Petitioners also argue that the difference in

amounts reported on the Federal returns versus the amounts in the restaurant's records suggests that the first accountant must have erroneously used the wrong client file when the original U.S. Corporation Income Tax Return for the fiscal year ended July 31, 1984 was prepared.

CONCLUSIONS OF LAW

A. Section 1138(a) of the Tax Law provides that if a return required to be filed is

¹A comparison of the original and amended returns shows that while there was a significant discrepancy in almost every account, a few accounts, in addition to payroll, did coincide. Those accounts which matched were beginning inventory, depreciation, net operating loss and travel and entertainment.

incorrect or insufficient, the Commissioner of Taxation and Finance shall determine the amount of tax due from such information as may be available. Moreover, if necessary, the tax may be estimated on the basis of external indices. When a taxpayer maintains a complete set of books and records, the Division is restricted to the use of those books and records because "[t]he honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

B. In this instance, petitioner had books and records which were available to the Division for examination. However, in view of the fact that petitioners did not make available check or cash disbursement records for the period August 1984 through May 1986 or records pertaining to one of the restaurant's bank accounts, it can not be said that petitioners had comprehensive records within the meaning of Matter of Chartair, Inc. v. State Tax Commn. (*supra*). The check and cash disbursement records allow an auditor to examine purchases. The purchase information, in turn, may be used to verify the accuracy of the sales records since there should be a relationship between the level of purchases and sales. Similarly, bank records are also important to verify the accuracy of sales information inasmuch as one may expect a relationship between the level of bank deposits and sales. Since the Division was not presented with comprehensive records, it was permissible for the Division to resort the use of external indices (*see, e.g., Matter of Urban Liquors, Inc. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138).

C. In determining the amount of sales tax liability, it is the duty of the Division to select a method "reasonably calculated to reflect the taxes due" (*see, Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, 206, cert denied 355 US 869). When the Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025).

D. Petitioners have established that the restaurant's first corporate income tax return for the fiscal year ended July 31, 1984 reported erroneous amounts. The fact that almost every amount on the original return was wrong supports petitioners' argument that the first accountant

must have mistakenly used the wrong client's file when the return was prepared. In this regard, petitioners have satisfactorily explained that bank deposits exceeded sales because the low level of sales made it necessary for the principals to make contributions to the restaurant. The same low level of food sales would also account for a high proportion of liquor purchases to food purchases. Lastly, petitioners have shown that the restaurant's purchases were generally made by check and that most of its sales were paid by credit card or check. Since the Division's conclusion that additional taxes are due was based on an erroneous Federal return, the notices of determination and demands for payment of sales and use taxes due, dated December 30, 1986, are cancelled.

E. In view of the foregoing, petitioners' remaining arguments are academic.

F. The petitions of New Jolly Swagman Inn Corp., Winfried Piechutski and Laura Piechutski, as officers of New Jolly Swagman Inn Corp., are granted and the notices of determination and demands for payment of sales and use taxes due, dated December 30, 1986, are cancelled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE